LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 7743 **NOTE PREPARED:** Jan 8, 2007
BILL NUMBER: HB 1720 **BILL AMENDED:**

SUBJECT: Enterprise Zone Incentives.

FIRST AUTHOR: Rep. Klinker **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: *EZ Business Participation Fees:* The bill authorizes a municipality to require an enterprise zone business to continue providing assistance to an Urban Enterprise Association that continues operating as a nonprofit corporation following the expiration of the enterprise zone. The bill also authorizes the nonprofit corporation to assign any amount of the assistance received from an enterprise zone business to another nonprofit corporation.

EZ Investment Deduction: The bill grants the redevelopment commission of an excluded city in Marion County the power to approve or reject an application for an Enterprise Zone Investment Deduction claimed for an enterprise zone location that is also within a redevelopment district in the excluded city. The bill changes the annual deadline for filing an Enterprise Zone Investment Deduction application. The bill allows a county auditor to grant a 30 day extension for filing for an Enterprise Zone Investment Deduction application. It allows an Urban Enterprise Association to waive a failure to file a timely or complete Enterprise Zone Investment Deduction application. It also allows a taxpayer to claim the Enterprise Zone Investment Deduction for an assessment date that occurs after the expiration of the enterprise zone.

EZ Loan Interest Credit: The bill increases the amount of the Enterprise Zone Loan Interest Credit from 5% to 15% of the interest received from qualified loans.

EZ Investment Cost Credit: The bill allows trusts, estates, corporations, and pass through entities to claim an Enterprise Zone Investment Cost Credit. (Current law allows pass through entities to claim the credit only in Vigo County and does not allow trusts, estates, or corporations to claim it in any county.)

EZ Job Creation Tax Credit: The bill establishes the Enterprise Zone Job Creation Tax Credit.

Effective Date: January 1, 2007 (retroactive); March 1, 2007 (retroactive); July 1, 2007.

Explanation of State Expenditures: The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the new EZ Job Creation Tax Credit and changes to the existing EZ Investment Cost Credit and EZ Loan Interest Credit. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *EZ Loan Interest Credit (LIC):* It is estimated that increasing the LIC from 5% to 15% of interest received could potentially reduce state revenue by about $1.8 M annually beginning in FY 2008. The revenue loss could begin in FY 2007 if taxpayers adjust their quarterly estimated payments.

EZ Investment Cost Credit (ICC): The bill extends the ICC to trusts, estates, corporations, and pass through entities effective beginning in tax year 2007. The fiscal impact of this change is indeterminable, but could potentially begin in FY 2008.

EZ Job Creation Tax Credit: It is estimated that the Job Creation Tax Credit could potentially reduce state revenue by about $1.4 M to $2.4 M in FY 2008 and about $1.5 M to $2.5 M in FY 2009. The revenue loss could begin in FY 2007 if taxpayers adjust their quarterly estimated payments. It is estimated that the revenue loss could potentially grow by about 1.5% to 2.5% annually thereafter.

Indiana Economic Development Corporation (IEDC): One percent of the incentive dollars obtained by taxpayers claiming EZ tax incentives could potentially flow to the IEDC through the EZ business registration fee. Businesses receiving EZ incentives must pay a fee equal to 1% of the incentives obtained by the business if the incentives exceed $1,000 during the year. The 1% fee in connection with: (1) the increase in the EZ Loan Interest Credit would generate about $18,000 annually (1% of $1.8 M in additional annual credits); and (2) the EZ Job Creation Tax Credit would generate about $14,000 to $24,000 in FY 2008 (1% of $1.4 M to $2.4 M in annual credits) and $15,000 to $25,000 in FY 2009.

Background Information: EZ Loan Interest Credit (LIC): The LIC is a nonrefundable tax credit that a taxpayer may claim against the AGI Tax, the Financial Institutions Tax, or the Insurance Premiums Tax. The credit is equal to 5% of the interest a taxpayer receives during the taxable year on qualified loans to businesses or individuals for specified uses in an EZ. The bill triples the LIC from 5% to 15% effective beginning in tax year 2007. The increase would apply to interest received from outstanding loans as well as new loans. Available data suggests that the LIC in existing EZs totals about $900,000 annually. Thus, the net fiscal impact from interest earned on outstanding loans and new loan activity that would occur independent of the increase in the LIC is estimated to total about $1.8 M annually. The fiscal impact of credits attributable to loans encouraged solely by the increase in the LIC is indeterminable.

EZ Investment Cost Credit (ICC): Under current statute, the ICC may be claimed against the Adjusted Gross Income (AGI) Tax by individuals purchasing an ownership interest (an equity investment) in an EZ business. Current statute allows pass through entities investing in businesses only in a Vigo County EZ to claim the ICC. The bill extends the ICC to trusts, estates, corporations, and pass through entities for equity investment in any EZ. Over the years $2.9 M in credits have been approved under the current structure of the ICC. Extending the ICC to taxpayers other than individuals could potentially increase the certification of new credits in future years. However, since data describing the investment behavior of EZ businesses is unavailable, the fiscal impact resulting from this change is indeterminable. Credits for investment that are encouraged by the change made under this bill presumably are not a revenue loss to the state. However, if the investment would have occurred in the absence of the change made by this bill, the net impact would be the total credits claimed by investors.

The ICC is equal to a maximum of 30% of the equity investment. The credit percentage allowed (up to 30%) varies depending upon the type of investment, the type of business, and the number of jobs created. The credit is nonrefundable, but a taxpayer may carry over excess credits to subsequent taxable years.

EZ Job Creation Tax Credit: The bill establishes the EZ Job Creation Tax Credit as a nonrefundable tax credit equal to $2,000 for each new employee employed by a taxpayer at an EZ location during the taxable year. The credit is effective beginning in tax year 2007. The credit could be claimed against the taxpayer's AGI Tax, FIT, or Insurance Premiums Tax liability. Under the bill, a new employee is an employee first employed by the taxpayer at the EZ location during the taxable year. It does not include an employee in a position previously held by another employee or an employee previously employed elsewhere in Indiana by another person or entity having a business relationship with the taxpayer. The credit is nonrefundable, but excess credits may be carried forward to succeeding tax years. The tax credit may not be carried back.

The net revenue impact of this credit depends on the extent that tax collections from new employees are less than or exceed the amount of credits claimed by the business. However, if the employees would have been hired in the absence of the tax credit, the net impact would be the total credits claimed by the business. It is estimated that the one-time $2,000 tax credit could potentially encourage about 45 to 50 new EZ jobs per year. This is based on: (1) estimates of the average percentage increase in demand for labor given a 1% reduction in the average wage; and (2) current employment and average wage levels within the EZs. The credits claimed for these jobs would total $100,000 annually. However, the revenue loss attributable to underlying employment growth (new employment that would occur independent of the tax credit) is estimated to total about $1.4M to $2.4M in FY 2008. This revenue loss could potentially increase by 1.5% to 2.5% annually. This estimate is based on long-run employment growth rates in cities or counties containing EZs and estimated current employment levels within the EZs.

Revenue from the AGI Tax on corporations, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: *EZ Investment Deduction:* The bill makes several changes relating to the EZ Investment Deduction beginning with 2007 Pay 2008 property taxes. The potential impact on utilization of the Investment Deduction due to these changes is indeterminable. The changes are as follows:

(1) The bill provides that the Investment Deduction for qualified investment in an EZ located within a redevelopment district of an excluded city in Marion County must be approved by that district's redevelopment commission. Currently, there are two EZs in Marion County, one in Indianapolis and the other at Ft. Benjamin Harrison which has territory located in the Lawrence.

(2) The bill extends the deadline for filing applications for the Investment Deduction from May 10th to May 15th each year. The bill also allows the county auditor to provide a 30-day extension for filing the application for the Investment Deduction, and allows the Urban Enterprise Association that operates an EZ to waive the failure to file a timely or complete application for the Investment Deduction.

(3) The bill allows a taxpayer to claim the Investment Deduction (up to the 10-year limit under current statute) for an assessment date after the expiration of the EZ in which the property where the qualified investment was made.

Background Information: The EZ Investment Deduction allows the increase in AV from "qualified investment" in real and/or personal property of an EZ business to be deducted for up to 10 years. A taxpayer must apply to the county auditor to claim the deduction for a particular year. The county auditor would determine whether the taxpayer is eligible for the deduction. Qualified investment at an EZ location includes: (1) purchase of a building, new manufacturing or production equipment, or new computers and related office equipment; (2) costs associated with the repair, rehabilitation, or modernization of an existing building and related improvements; (3) onsite infrastructure improvements; (4) construction of a new building; and (5) costs associated with retooling existing machinery.

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation.

Local Agencies Affected: County auditors; Local units containing Enterprise Zones; Lawrence Redevelopment Commission.

Information Sources: OFMA Enterprise Zone database; State Enterprise Zone Business Registration data 1995-2001; Bureau of Labor Statistics, *Local Area Unemployment Statistics* database - 1990-2005; Sarah Lowe, *Indiana Enterprise Zone Program: Employment and Fiscal Impact Analysis of a Job Creation Tax Credit*, Thesis, Purdue University, 2004; Kim Clark & Richard Freeman, "How Elastic is the Demand for Labor?" *The Review of Economics and Statistics*, 1980.

Fiscal Analyst: Jim Landers, 317-232-9869.